REASONABLENESS OF MAXIMUM RATES AS A CONSTITUTIONAL LIMITATION UPON RATE REGULATION.

THOMAS JEFFERSON, urging the necessity of a Bill of Rights in the Constitution of the United States, wrote to James Madison from Paris, March 15, 1789, as follows: "This instrument forms us into one state, as to certain objects, and gives us a legislative and executive body for these objects. It should, therefore, guard us against their abuses of power within the field submitted to them . . . The tyranny of the legislature is the most formidable dread at present and will be for many years. That of the executive, will come in its turn; but it will be at a remote period."[1] Freedom was the dominant issue of the times — not only political, but civil and religious freedom — and it is not surprising that the wisdom and foresight of the framers of the Constitution embodied in the Fifth Amendment the provision concerning personal rights and private property:

"nor shall any person . . . be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation."

Eighty years later, in substantially the same form, there was adopted in the Fourteenth Amendment the following clause:

"nor shall any state deprive any person of life, liberty, or property without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws."

That the fundamental principles of personal liberty and private property as declared by the Magna Carta, the Petition of Rights, and the Bill of Rights were a part of the common law at the time the delegates assembled to prepare the Constitution of the United States in 1787, was denied by none. But, strange to say, Hamilton is found in opposition to the inclusion of a Bill of Rights in the Constitution of the United States, although he admitted that it

[1] 3 Jefferson's Works, 4, 5, 201. See also 2 *ibid.*, 329.

constituted a part of the Constitution of England.[1] His assigned reason was that a government emanating from the people and not from a hereditary sovereign could do no wrong. The rights of personal liberty and of private property, to the mind of Hamilton, existed merely as legislative enactments of prevailing public opinion; that the purpose of a constitution was merely "to regulate the general political interests of the nation," and that it had no concern with personal and private rights, a declaration of which "would sound much better in a treatise of ethics than in a constitution of government."[2] It is fortunate for this country that the views of Hamilton, although prevailing in the Constitution itself, were later repudiated, and that a Bill of Rights was adopted in 1789–91 in the form of the first ten Amendments; for it is now well recognized that a legislative majority cannot be trusted to deal fairly with the liberty and property of the individual. The foregoing provision of the Fourteenth Amendment was merely an application to the states of the similar provision in the Fifth Amendment limiting the power of the federal government. It restricts the police power of the states and confers upon the federal judiciary authority to determine whether the fundamental and inalienable rights of a person to his life, liberty, and property have been infringed. Consequently, since its adoption all questions pertaining to the deprivation of life, liberty, and property without due process of law must receive their ultimate and final determination in the Supreme Court of the United States. Shall the "due process of law" clause be given the meaning and intent with which it spoke when adopted, or shall it serve merely as a mirror to reflect the popular opinions and passions of the day? If these great and fundamental guaranties of life, liberty, and property have a historical meaning and force, that fact should be so declared and should operate as a constitutional barrier against the unrestrained enactment of dominant opinion into law.[3]

There is no dispute that the right of the individual to the enjoy-

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[1] Slaughter-House Cases, 16 Wall. (U. S.) 36, 114.

[2] The Federalist, Number 84.

[3] Mr. Justice Brewer in South Carolina *v.* United States, 199 U. S. 437, 448, said: "The Constitution is a written instrument. As such, its meaning does not alter. That which it meant when adopted, it means now . . . In other words, while the powers granted do not change, they apply from generation to generation to all things to which they are, in their nature, applicable. This in no manner abridges the fact of its changeless nature and meaning. Those things which are within its grants of power, as those grants were understood when made, are still within them, and those things not within them remain still excluded."

ment of his property is subject to the legitimate exercise of the police power. But when the exercise of this power interferes with the property rights of an individual, it raises a judicial question as to whether it is more vital to the welfare of the community that the individual be allowed to use and enjoy his property without the particular legislation complained of, or whether the legislative restraint should prevail. If the legislation tends to promote the health,[1] the safety,[2] the morals,[3] or the order and peace of the community,[4] the general public convenience,[5] or tends to promote the general welfare and prosperity of the community,[6] the only proper judicial inquiry is whether or not such legislation has a real and substantial relation to the ends sought to be accomplished.[7] If it has, the rights of the individual must yield to the general welfare of the community.

In respect to that indefinite field of the police power which lies outside of the aforesaid purposes, restrictive legislation is less essential to the public welfare, and not only disturbs economic conditions, but must result in either favoritism or oppression. This field covers what might be termed the economic interests of the community. The justification of such legislation is the possibility of oppression or undue advantage which the accumulation of capi-

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[1] Holden *v.* Hardy, 169 U. S. 366 (hours of labor in mines and smelters); Jacobson *v.* Massachusetts, 197 U. S. 11 (compulsory vaccination); Mugler *v.* Kansas, 123 U. S. 623 (prohibition of manufacture and sale of liquors); People *v.* Van De Carr, 199 U. S. 552 (sale of milk); California Reduction *v.* Sanitary Reduction, 199 U. S. 306; Gardner *v.* Michigan, 199 U. S. 325 (disposal of garbage).

[2] N. Y. & N. E. R. R. *v.* Bristol, 151 U. S. 556, 571; C., B. & Q. R. R. *v.* Chicago, 166 U. S. 226, 255 (eliminating grade crossings); Barbier *v.* Connolly, 113 U. S. 27 (closing of laundries from 10 P. M. to 6 A. M.).

[3] Douglas *v.* Kentucky, 168 U. S. 488 (lotteries); Otis *v.* Parker, 187 U. S. 606 (stock transactions on margin).

[4] Mugler *v.* Kansas, *supra;* Hennington *v.* Georgia, 163 U. S. 299 (running of freight trains on Sunday).

[5] L. S. & M. S. Ry. Co. *v.* Ohio, 173 U. S. 285 (requiring railroads to stop trains at regular stations); Atlantic Coast Line *v.* Commission, 206 U. S. 1 (requiring railroads to operate certain trains); Wisconsin, etc., Ry. *v.* Jacobson, 179 U. S. 287 (enforcing track connections between two railroads); Escanaba Co. *v.* Chicago, 107 U. S. 678 (opening and closing of bridges over navigable streams).

[6] Scranton *v.* Wheeler, 179 U. S. 141 (changing the level of navigable waters); Transportation Co. *v.* Chicago, 99 U. S. 635 (changing grade of a public highway by carrying it in a tunnel under navigable waters); West Chicago St. R. R. *v.* Chicago, 201 U. S. 506 (requiring the removal of a street railroad tunnel which obstructs navigable waters); C., B. & Q. Ry. *v.* Drainage Commissioners, 200 U. S. 561, 592 (reclamation of swamp lands); Bacon *v.* Walker, 204 U. S. 311 (pasturage of sheep on public domain within two miles of a dwelling-house).

[7] Mugler *v.* Kansas, *supra*, 661 *et seq.*

tal or labor has power to create.[1] From time immemorial monopolies and combinations in restraint of trade have been subject to legislative control.[2] Aside from anti-trust legislation, the most important exercise of the police power in respect to economic interests is the regulation of rates of charge. Under this head come usury laws, inn-keepers' charges, regulation of charges for elevating and storing grain,[3] for the care of live-stock in stock-yards,[4] for transportation on railroads,[5] for telephone service,[6] and charges for the supply of water[7] and gas.[8]

Fundamentally the purpose of restricting or prohibiting monopolies is not different from that of regulating rates of charge. The anti-trust laws tend to create competitive conditions and the adjustment thereby of the rates of charge at the real value of the service rendered.[9] Legislation regulating rates of charge substitutes, in place of competition, the fiat of the legislature. The purpose of both is the same, the prevention of economic oppression — yet a striking difference exists between these two forms of legislation with respect to the conditions resulting from them. Anti-trust laws, in preventing or restricting the great combinations of wealth, foster and promote competition and freedom of contract. On the other hand, rate regulation leaves monopolistic combinations as it finds them, and interferes directly with the management of business and the right to make contracts. It is thus much more radical legislation, and in reality a form of paternalism. However, both anti-trust legislation and rate regulation pertain to the purely economic interests of the community, and present an entirely different question from that arising under the exercise of the police power for the other enumerated purposes, in that the right of the state to interfere is based solely upon the ground that the pur-

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[1] Munn *v.* Illinois, 94 U. S. 113, 131, 132. See Beale, R. R. Rate Regulation, §§ 55, 66.

[2] Slaughter-House Cases, 16 Wall. (U. S.) 36, 104, 105; United States *v.* Joint Traffic Ass'n, 171 U. S. 505, 569; United States *v.* Trans-Missouri Freight Ass'n, 166 U. S. 290; Northern Securities Co. *v.* United States, 193 U. S. 197, 337, 339. See also Freund, Police Power, §§ 330, 338 *et seq.*

[3] Munn *v.* Illinois, 94 U. S. 113; Budd *v.* New York, 143 U. S. 517; Brass *v.* North Dakota, 153 U. S. 391.

[4] Cotting *v.* Kansas City Stockyards, 183 U. S. 79.

[5] C., B. & Q. Ry. *v.* Iowa, 94 U. S. 155; Railroad Commission Cases, 116 U. S. 307.

[6] Hockett *v.* State, 105 Ind. 250.

[7] Spring Valley Water Works *v.* Schottler, 110 U. S. 347.

[8] State *v.* Columbus Gas Light & Coke Co., 34 Oh. St. 572.

[9] United States *v.* Trans-Missouri Freight Ass'n, 166 U. S. 290, 339.

chaser is at an economic disadvantage and is unable to buy at a fair and reasonable price. Where the court is confronted with a question involving merely the accumulation of capital or labor and the concomitant disadvantage of the consumer, it is necessary for it to consider a question of economics. It may either start from the point of view of paternalism, that the legislature should have the widest possible discretion in the determination of what is to the best interests of the individual, or it may start from the point of view of individualism, that the welfare of the country is better served by permitting the freest possible individual liberty in respect to the use and enjoyment of property consistent with the public good. It is not incumbent upon the court to accept either socialism or the doctrine of *laissez faire*. But how can it reach a conclusion as to the limitations of legislative power upon a purely economic question, unless it adopts some theory of economics?

Governmental regulation, as such, is a conceded legislative power. The determination of the limits of this power, however, involves a question of constitutional interpretation. A constitution not only defines the powers and duties of the government, but also the rights and duties of the governed, and is, therefore, the embodiment of the "organic relation of the citizen to the state." Although it may be conceded that the provisions of the Fourteenth Amendment do not enact Mr. Herbert Spencer's Social Statics,[1] yet these guaranties must be interpreted in the light of some theory of government. The refusal of the judiciary to determine the limits of the police power would be an evasion of its duty to declare that "this Constitution . . . shall be the supreme law of the land"[2] and would result in denying to the individual those fundamental rights of personal liberty and private property which are the heritage of the English-speaking race. The majority of the court in Lochner *v.* New York[3] maintained that the court *must* ascertain the proper limits of the police power in every case which comes before it, and that if it permitted legislation to stand whenever there might exist a difference of opinion as to its constitutionality "the claim of the police power would be a mere pretext — become another and delusive name for the supreme sovereignty of the state to be exercised free from constitutional restraint."[4] Underlying this decision and forming the basis thereof is the doctrine of individualism as con-

[1] Mr. Justice Holmes' dissenting opinion, Lochner *v.* New York, 198 U. S. 45, 75.
[2] Constitution, Article VI.
[3] 198 U. S. 45.
[4] P. 56, Mr. Justice Peckham.

trasted with paternalism. "Due process of law" is construed to guarantee the greatest possible individual freedom consistent with the public welfare. The court will scrutinize carefully the ground or reason upon which the legislation is justified, for the purpose of determining whether or not it constitutes a material danger to the public welfare. The position of Mr. Justice Holmes would be destructive of all constitutional interpretation in cases of this kind, and would constitute the legislature the supreme judge upon all questions of the right to contract and to enjoy and dispose of property. The position of Mr. Justice Harlan is equally inadmissible,[1] in that it opens wide the door "for the play and action of purely personal and arbitrary power."[2] It admits that the limitation of the police power is a judicial question, yet refuses to establish any basis or test for its determination. Any other position than that taken by the majority would not only amount to a failure to discharge the duty imposed upon the judiciary by the Constitution, but would permit an encroachment by the legislature upon the property rights of the individual, which by gradual process might change over society from an individualistic to a socialistic basis. As the Constitution has endeavored to insure to the individual the greatest possible personal liberty consistent with public welfare, it would seem that the greatest possible protection of his property is both the limitation and the duty of government.[3] The spirit of our institutions is essentially individualistic, and this fact must have a controlling influence in the interpretation of the Constitution upon purely economic questions.

This doctrine or policy of government applies directly to rate regulation. No disadvantage of the consumer in dealing with the producer requires that the producer be divested of the management of his business. The state has no general and unlimited right to interfere between the producer and the consumer as to the price at which the public shall be served. The only justification of the exercise of police power in this instance is to prevent exorbitant and oppressive rates of charge, and that object is accomplished when the regulation assures to the public reasonable and fair rates. Rate regulation, therefore, must be limited to the establishment of maximum rates, "beyond which the company cannot go, but within which it is at liberty to conduct its work in such a manner as

[1] P. 72.

[2] Yick Wo *v.* Hopkins, 118 U. S. 356, 370.

[3] Budd *v.* New York, 143 U. S. 517, 551. Dissenting opinion, Mr. Justice Brewer.

may seem to it best suited for its prosperity and success."[1] The power of the legislature to regulate is exhausted when it has fixed a maximum rate. Legislation restricting the management of the business by fixing absolute, minimum, commutation, or other arbitrary rates, is unconstitutional and void.[2]

In the absence of legislative regulation upon the subject the proper rate or charge is primarily a judicial question. The company or person rendering the service is entitled to receive reasonable compensation. This rule prevailed at common law.[3] Statutory regulation was not intended to change this rule, but to substitute a primary legislative determination in place of a judicial determination as to what constitutes a reasonable maximum rate. This was conceded unreservedly, even in Munn *v.* Illinois.[4] Only the right to regulate, as such, was involved in that case, and the dictum therein contained that this power is unlimited, was later repudiated.[5] In 1890 the reasonableness of a legislative rate was held to be a judicial question.[6] Shortly afterwards it was conceded that the power of the legislature is merely to protect the public against unreasonable rates.[7]

Although the rule laid down in Smyth *v.* Ames[8] is now well

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[1] Lake Shore, etc., Ry. Co. *v.* Smith, 173 U. S. 684, 691.

[2] *Ibid.*

[3] Interstate Com. Com. *v.* Baltimore & Ohio, 145 U. S. 263, 275.

[4] 94 U. S. 113, 134. Chief Justice Waite said in his opinion: "So, too, in matters which do affect the public interest, and as to which legislative control may be exercised, if there are no statutory regulations upon the subject, the courts must determine what is reasonable. The controlling fact is the power to regulate at all. If that exists, the right to establish the maximum of charge, as one of the means of regulation, is implied. In fact, the common law rule, which requires the charge to be reasonable, is itself a regulation as to price. Without it the owner could make his rates at will, and compel the public to yield to his terms, or forego the use.

"But a mere common law regulation of trade or business may be changed by statute. . . . Indeed, the great office of statutes is to remedy defects in the common law as they are developed, and to adapt it to the changes of time and circumstances. To limit the rate or charge for services rendered in a public employment, or for the use of property in which the public has an interest, is only changing a regulation which existed before. It establishes no new principle in the law, but only gives a new effect to an old one." See also language of Mr. Justice Brewer in Reagan *v.* Farmers' Loan & Trust Co., 154 U. S. 362, 397.

[5] Railroad Commission Cases, 116 U. S. 307, 331 (1886).

[6] Chicago, etc., R. R. *v.* Minnesota, 134 U. S. 418, 458.

[7] Railway *v.* Wellman, 143 U. S. 339, 343. "The legislature has power to fix rates and the extent of judicial interference is protection against unreasonable rates." Reagan *v.* Farmers' Loan & Trust Co., 154 U. S. 362, 397, 399. Covington, etc., Turnpike Co. *v.* Sandford, 164 U. S. 578, 596.

[8] 169 U. S. 466, 545, 547. Mr. Justice Harlan said in his opinion: ". . . the gov

established, that a "state enactment . . . that will not admit of the carrier earning such compensation as under all the circumstances is just to it and to the public" is unconstitutional and void, the principles by which the question of reasonableness must be determined are only negatively disclosed by the subsequent decisions of the Supreme Court. In many cases the proof has been held inadequate,[1] and in others the reasonableness or unreasonableness of the rates was so clear that the discussion of the fundamental rule was unnecessary.[2] The difficulty lies in framing a standard of reasonableness. With respect to an entire schedule, the test which has been most generally applied is that the schedule should afford the capital invested a return equal to that received by capital invested in similar enterprises. In respect to individual rates the Supreme Court of the United States has not yet definitely settled either that the reasonableness of the same may be judicially raised or what test is to be applied for the determination thereof. Individual rates, however, must fall within certain limits. The charge cannot exceed the value added by the service, nor can the charge be less than the cost of rendering the service. What would be a reasonable rate within these limitations has not been decided. Theoretically the individual rate should bear its proportionate share of the total expenditures of the company, but practically this rule is extremely difficult of application.[3]

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ernment may, by legislation, protect the people against unreasonable charges for the services rendered by it [the company]." "On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it [the company] are reasonably worth."

[1] Dow *v.* Beidelman, 125 U. S. 680; Chicago, M. & St. P. Ry. Co. *v.* Tompkins, 176 U. S. 167; San Diego, etc., Co. *v.* National City, 174 U. S. 739; Minneapolis & St. Louis R. R. *v.* Minnesota, 186 U. S. 257; Atlantic Coast Line *v.* Florida, 203 U. S. 256.

[2] Stanislaus County *v.* San Joaquin, 192 U. S. 201 (reasonable).

[3] Noyes, American Railroad Rates, 28 *et seq.* United States *v.* Trans-Missouri Freight Ass'n, 166 U. S. 290, 331, by Mr. Justice Peckham: "What is a proper standard by which to judge the fact of reasonable rates? Must the rate be so high as to enable the return for the whole business done to amount to a sum sufficient to afford the shareholder a fair and reasonable profit upon his investment? If so, what is a fair and reasonable profit? That depends sometimes upon the risk incurred, and the rate itself differs in different localities: which is the one to which reference is to be made as the standard? Or is the reasonableness of the profit to be limited to a fair return upon the capital that would have been sufficient to build and equip the road, if honestly expended? Or is still another standard to be created and the reasonableness of the charges tried by the cost of the carriage of the article, and a reasonable profit allowed on that? And in such case would contribution to a sinking fund to make repairs upon the road-bed and renewal of cars, etc., be assumed as a proper item? Or is the reasonableness of the charge to be tested by reference to the

The decisions are uniform that where the regulation consists of the establishment of a schedule of rates based upon the classification of rates charged by the railroad itself, and affecting either the entire business of the company or such a well-defined class of traffic as the passenger or freight business, the rule or test is that the constitutionality of the regulation will depend upon its effect upon the entire business of the company, or such freight or passenger traffic.[1] The unreasonableness of the rates was held to be established when it appeared that the net income of the company or person affected by the regulation would not be sufficient to discharge the necessary expenditures for operation. In Smyth *v.* Ames, however, the court went further, and held that the carrier, in addition to its proper expenditures, was entitled to receive for its services "just compensation." The method suggested by Mr. Justice Harlan was to ascertain the fair value of the property used for the public convenience, the gross earnings and expenses, and the probable net earnings under such regulation. A comparison of such net earnings with the valuation would determine whether or not the probable income would amount to "just compensation." In short, the test of "due process of law" is the confiscation of the entire property and is determined by an analysis of the entire business of the company. No attempt was there made in any way to challenge the reasonableness of any particular rate, nor was the classification made by the Board of Transportation subjected to criticism. The attention of the Supreme Court, therefore, was not directed to these questions, and nothing which the court may have said in that case or in its subsequent decisions[2] should be construed as an opinion that the test therein enunciated was of universal application.

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charges for transportation of the same kind of property made by other roads similarly situated? If the latter, a combination among such roads as to rates would, of course, furnish no means of answering the question. It is quite apparent, therefore, that it is exceedingly difficult to formulate even the terms of the rule itself which should govern in the matter of determining what would be reasonable rates for transportation." See Freund, Police Power, § 550.

[1] Reagan *v.* Farmers' Loan & Trust Co., *supra*, 399; Smyth *v.* Ames, *supra*. In these cases the tariff, as a whole, was challenged, and no complaint was made of the classification of the traffic adopted by the commission. In St. Louis & San Francisco Ry. *v.* Gill, 156 U. S. 649, it was held that proof limited to *one division of a railroad* was insufficient to show the unreasonableness of a passenger rate affecting the entire railroad.

[2] San Diego, etc., Co. *v.* National City, *supra*; Stanislaus County *v.* San Joaquin, *supra*.

Without in any way detracting from the rule laid down in Smyth *v.* Ames, it may be confidently asserted that underlying that case and all the decisions of the Supreme Court upon rate regulation the more fundamental principle and the basis of all calculations is that no one can constitutionally demand a service to be rendered at less than cost or the fair value of the service.[1] In 1900 Mr. Justice Brewer said:[2] "Few cases are more difficult or perplexing than those which involve an inquiry whether the rates prescribed by the state legislature for the carrying of passengers and freight are unreasonable. And yet this difficulty affords no excuse for a failure to examine and solve the questions involved." The problem was still unsolved in 1901 when the same learned justice, in commenting upon the former rulings of the Supreme Court, said: "There has been no further ruling than that the state may prescribe and enforce reasonable charges. What shall be the test of reasonableness in those charges is absolutely undisclosed."[3]

In 1902 a case came before the Supreme Court which might have definitely settled the proper test or rule if the proof offered by the complainant had been adequate and had shown the unreasonableness of the rates in question.[4] This was an action in

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[1] In Smyth *v.* Ames, *supra*, 544, Mr. Justice Harlan, speaking for the court, said: "But the rights of the public would be ignored if rates for transportation of persons or property on a railroad are exacted without reference to the fair value of the property used for the public *or the fair value of the services rendered.*" See also San Diego, etc., Co. *v.* National City, 174 U. S. 739, 757.

In Cotting *v.* Kansas City Stockyards Co., 183 U. S. 79, 91, 95, Mr. Justice Brewer, in speaking of the attitude of the court, said: "It has been declared that the present value of the property is the basis by which the test of reasonableness is to be determined, although the actual cost is to be considered, and that the *value of the services rendered to each individual* is also to be considered. . . .

"Pursuing this thought, we add that the state's regulation of his charges is not to be measured by the aggregate of his profits determined by the volume of business, but by the question whether any particular charge to an individual dealing with him is, considering the service rendered, an unreasonable exaction. . . . The question is not, how much does he make out of the volume of business; but whether, in each particular transaction, the charge is an unreasonable exaction for the services rendered. He has a right to do business. He has a right to charge for each separate service that which is reasonable compensation therefor, and the legislature may not deny him such reasonable compensation and may not interfere simply because out of the multitude of his transactions the amount of his profits is large. Such was the rule of the common law even in respect to those engaged in a quasi-public service, independent of legislative action."

[2] Chicago, M. & St. P. Ry. *v.* Tompkins, 176 U. S. 167, 172.

[3] Cotting *v.* Kansas City Stockyards, *supra*, 91.

[4] Minneapolis & St. Louis R. R. *v.* Minnesota, 186 U. S. 257.

mandamus by the State Railroad & Warehouse Commission of Minnesota to compel the defendant railroads to adopt specific rates on hard coal in car-load lots from Duluth to various points southwest from Minneapolis. The defense undertook to show that because the average cost of carrying freight of all kinds per ton per mile during the preceding year was greater than the revenue derived per ton per mile for carrying coal at the rates prescribed by the commission, therefore such rates were unreasonable. The defendant further proved that if the rates fixed by the commission for coal in car-load lots were applied to all freight carried by the road it could not pay its operating expenses. No proof, however, was offered as to the cost of carrying hard coal in car-load lots on the entire railroad or between the points mentioned in the schedule. A careful analysis of the whole opinion will lead to the conclusion that had the company been able to segregate the cost of the transportation of hard coal from the cost of its remaining business, and had the coal so transported been a substantial portion of the company's traffic and the cost of such transportation been found to be greater than the compensation allowed by the commission, the court would have granted the relief sought. This conclusion is irresistible, for if the court believed that the aggregate method, as laid down in Smyth *v.* Ames, was applicable for the determination of the reasonableness of specific rates, this case could have been disposed of summarily. The net income for the year under consideration applicable to dividends was $458,662.04,[1] yet the total amount received on the traffic affected by the rates in question was only $3,874.50. A regulation compelling the railroad to carry this traffic for nothing would have reduced the revenue for that year only $3,874.50, while if the rates fixed by the commission had been in effect for the same time the loss of revenue would have been only $1,409.72.[2] The loss of $1,409.72 would have been of no consequence whatsoever if the constitutionality of this regulation had been tested by the rule announced in Smyth *v.* Ames. The Supreme Court would certainly not have given the case the elaborate consideration it apparently received unless in its judgment either the value or the cost of rendering the service was the appropriate test to be applied. The true rule seems to be taking definite form in this case, to wit, that a regulation is unconstitu-

[1] State *v.* Minneapolis & St. Louis R. R., 80 Minn. 191, 198.
[2] Minneapolis & St. Louis R. R. *v.* Minnesota, *supra*, 265.

tional and void, *if it compels a service to be rendered at less than cost, irrespective of its effect upon the entire business.*[1]

In all cases, therefore, where the rule laid down in Smyth *v.* Ames, that the reasonableness of the rates must be tested upon an aggregate basis, has no tendency to show whether the rates are reasonable or unreasonable, that rule must be rejected. It must be remembered that in the railroad cases in which the rates were held unreasonable,[2] there existed a classification of traffic based upon the value, weight, and size of various kinds of freight, the distance transported, and many other factors, applicable to which a schedule of rates based upon these considerations had been voluntarily put in force by the carriers themselves. Inasmuch as the state regulation consisted of a horizontal reduction of these rates it is apparent that such regulation affected the earnings as a whole, similar in manner as it affected the earnings of any class of traffic. That is, the total receipts and expenditures of the railroad reflected the receipts and expenditures of any particular class of service. What, therefore, was true of the reasonableness of the schedule as a whole was true of the various classes of traffic. As the carrier did not challenge the propriety of any particular rate on any particular class of traffic, it was quite natural that the court should test the constitutionality of the legislation upon an aggregate basis. It does not, however, follow, because such aggregate method of proof was adopted in those cases, that if the complainant had expressly challenged the right of the state to establish certain classes of service, the question would not have been determined upon the basis of the value or the cost of such service.

For similar reasons the reasonableness of a regulation which fails to classify a business in which the costs of the various classes

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[1] Beale, R. R. Rate Regulation, § 325; Noyes, American Railroad Rates, 250, 252. In Atlantic Coast Line R. R. Co. *v.* Florida, 203 U. S. 256, 260, Mr. Justice Brewer for the court said: "And here we face this situation: the order of the commission was not operative upon all local rates, but only *fixed the rate on a single article;* to wit, phosphate. There is no evidence of the amount of phosphates carried locally; neither is it shown how much a change in the rate of carrying them will affect the income, nor how much the rate fixed by the railroads for carrying phosphates has been changed by the order of the commission. . . . *But there is nothing from which we can determine the cost of such transportation.* We are aware of the difficulty which attends proof of the cost of transporting a single article, and in order to determine the reasonableness of a rate prescribed, it may sometimes be necessary to accept as a basis the average rate of all transportation per ton per mile." See Seaboard Air Line *v.* Florida, 203 U. S. 261; Alabama, etc., Ry. *v.* Mississippi, 203 U. S. 496.

[2] Reagan *v.* Farmers' Loan & Trust Co., *supra*, Smyth *v.* Ames, *supra*.

of service are different, or which arbitrarily classifies such service without regard to the cost thereof, could not be tested by the rule laid down in Smyth *v.* Ames. Take, for example, the establishment of a single maximum rate of five cents per ton-mile for all railroad traffic, both freight and passenger, and suppose that at such rate the total number of ton-miles transported during the previous year would yield sufficient income to pay the operating expenses, fixed charges, and earn something on the stock. If the carrier were able to continue business on this basis, it might be said that five cents per ton-mile was a living rate, but does this method of proof show that five cents is a *proper maximum rate*, in view of the fact that the traffic of the railroad is so diversified that the various costs of service per ton-mile may vary from one to ten cents. It is, moreover, extremely unlikely that under the conditions suggested the railroad could secure the same amount of traffic after regulation as it had before. An arbitrary rate of five cents per ton-mile would prohibit the transportation of many commodities which could have been carried at a profit at a less rate. The amount of traffic carried would depend not only upon the law of supply and demand, but also upon the price which the public could afford to pay for the commodities transported. Even if the result of such regulation would be to give to the company a profit on its entire business, would not the application of the rule in Smyth *v.* Ames result in entirely losing sight of the fundamental purpose of rate regulation, the assurance to the public of reasonable rates of charge? Can it be said that every rate is a proper maximum rate which is the result of lumping the entire business and striking an average? Is the right to fix a maximum rate to be construed to mean an average rate? If so, the purpose of governmental regulation would be entirely changed, for theoretically the right of the state is merely to prevent extortion and oppression, while if such method were adopted many rates might be legally established at a price below the actual cost of service. No one would contend that it was necessary for the protection of the public, demanding a certain class of service, that the maximum rate be fixed below the cost of furnishing that service. The judiciary, in framing a test or method for determining the validity of such a legislation, should carry out the fundamental purpose of the police power; that is, if the power of the state is limited to fixing a reasonable maximum rate, the test or method of proof should not permit the state to further encroach upon the rights of private property. The rule in Smyth *v.* Ames

will be of no assistance in solving the constitutional question of the reasonableness of particular rates on a portion of the traffic, or of a single maximum rate or a complete schedule of rates based upon an arbitrary classification, for it is obvious that the application of such a test entirely loses sight of the fundamental purpose of rate regulation.[1]

The ultimate position of the Supreme Court of the United States is unquestionably forecasted in the recent case of Atlantic Coast Line R. R. Co. *v.* North Carolina Corporation Commission.[2] Although the court enforced an order of the commission compelling the railroad to operate a train between certain points at an actual loss, yet it carefully distinguished an order in respect to a public convienence which did not *necessarily* entail a loss, and the regulation of rates which would inevitably have that result. And in disposing of that particular case, the court, by Mr. Justice White, said: [3]

"Let it also be conceded that a like repugnancy to the Constitution of the United States would arise from an order made in the exercise of the power to fix a rate when the result of the enforcement of such order would be to compel a carrier to serve, for a wholly inadequate compensation, a class or classes selected for legislative favor, even if, considering rates as a whole, a reasonable return from the operation of its road might be received by the carrier. . . . It follows, therefore, that the mere incurring of a loss from the performance of such a duty does not in and of itself necessarily give rise to the conclusion of unreasonableness, as would be the case where the whole scheme of rates was unreasonable, under the doctrine of Smyth *v.* Ames, or under the concessions made in the two propositions we have stated."

The importance of this "concession," as bearing upon the fundamental rules of rate regulation cannot be overestimated, as the court is evidently of the opinion that the rule as laid down in Smyth *v.* Ames is not controlling in all cases, and should not be applied if it has no tendency to demonstrate the unreasonableness of the rate. Great emphasis was placed upon the importance of a just classification of the service and the allowance of remunerative rates for furnishing each class of such service; *i. e.* constitu-

[1] The reasonableness of individual rates may be tested without making an elaborate analysis of costs by merely showing the customary or current rates for similar service under similar conditions. Cotting *v.* Kansas City Stockyards, *supra*, 97, 98; Canada Southern Ry. *v.* Internat'l Bridge, 8 App. Cas. 723.

[2] 206 U. S. 1.

[3] P. 26.

tional protection should not be limited to the entire business of a public service company, but should be applied and enforced whenever the legislation compels the company to serve a distinct class of service at a loss, "to the detriment of other class or classes upon whom the burden of such loss would fall."

The following analysis covers the field of rate regulation in respect both to its extent and to the uniformity or diversification of the cost of service:

1. A schedule of maximum rates for the entire business.
2. A single maximum rate for the entire business.
3. A single maximum rate for a portion of the business.

The cost per unit of rendering public service may be either uniform or diversified, owing to varying conditions.

The various combinations under the above classification will be considered separately.

First: Where a schedule of maximum rates applies to the entire business of a company, the proper test is that employed in Smyth *v.* Ames; *i. e.*, if such schedule is based upon the classification adopted by the railroad and consists of a horizontal reduction. If, however, the state does not base its regulation upon existing classifications and rates of the company, the situation presented is that considered under the fourth heading.

Second: Where a single maximum rate applies to a service of which the cost per unit is uniform, the aggregate net earnings of the company reflect the measure of profit for the unit, and the reasonableness of the rate as a maximum.[1]

Third: Where a single maximum rate is made applicable to a certain class of service, the test of the reasonableness of such rate is the value or cost of furnishing such service.[2]

Fourth: Where a single maximum rate is made applicable to the entire business and the cost of service per unit is variable, the legislation cannot constitutionally ignore this variable quantity which requires a classification of the service and the proper adjustment of rates thereto. In the absence of such a classification and adjustment the propriety of the single maximum rate must be tested with respect to the cost of rendering each separate and distinct class of service which the public may demand under such

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[1] Such, for instance, was the test in San Diego, etc., Co. *v.* National City, *supra*; San Diego, etc., Co. *v.* Jasper, 189 U. S. 439; Stanislaus County *v.* San Joaquin, *supra*.

[2] This appears to be the principle laid down in Minneapolis & St. Louis R. R. *v.* Minnesota, *supra*.

regulation. This precise situation was presented in the case of The Columbus Railway & Light Co. *v.* City of Columbus.[1] A single maximum rate of five cents per kilowatt hour was there made applicable to a service which varied in cost from twelve cents per unit to about three cents per unit. The ordinance was held unconstitutional, regardless of the fact that upon the entire business of the company there would be a reasonable return, for the reason that "a single maximum rate requiring that a substantial definitely ascertainable portion of the service be rendered at less than cost, is a violation of the Fourteenth Amendment, and constitutes a taking of property without due process of law." Where there is no existing classification of rates established by the company, which might operate as an estoppel *in pais*, the same rule applies to a schedule of maximum rates in which the legislation improperly classifies the service and improperly adjusts the rates thereto.[2]

These conclusions are sustained by other considerations growing out of the fundamental obligations of public service. In addition to the duty of rendering service at reasonable prices, a public service company must do so without unjust discrimination, and furthermore, such a company must continue to render service to the public whether it desires to do so or not.[3] If such company could refuse to render any unremunerative service, or any service at all, as in case of a lender of money under the usury laws, the situation would be very different. The right, therefore, of every member of the public to demand service makes it imperative that the question of the value or cost of that service be taken into consideration in the establishment of either a schedule of rates or of particular rates on a portion of the entire business. The interests

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[1] Decided August 1, 1906, by the Circuit Court of the United States for the Southern District of Ohio.

[2] Atlantic Coast Line *v.* North Carolina, *supra*, 25, 26.

"Let it be conceded that if a scheme of maximum rates was imposed by state authority, as a whole adequately remunerative, and yet that some of such rates were so unequal as to exceed the flexible limit of judgment which belongs to the power to fix rates, that is, transcended the limits of just classification and amounted to the creation of favored class or classes whom the carrier was compelled to serve at a loss, to the detriment of other class or classes upon whom the burden of such loss would fall, that such legislation would be so inherently unreasonable as to constitute a violation of the due process and equal protection clauses of the Fourteenth Amendment."

[3] Western Union Tel. Co. *v.* Call Pub. Co., 181 U. S. 92; Hays *v.* Pennsylvania Co., 12 Fed. 309; Scofield *v.* Ry. Co., 43 Oh. St. 571; Messenger *v.* Pennsylvania R. R., 36 N. J. L. 407; United States *v.* Trans-Missouri Freight Ass'n, 166 U. S. 290, 321, 322.

of both the owner of the property and the public must be taken into consideration in the regulation of rates.[1] Although the purpose of the owner is to frame a schedule of rates which, as a whole, will yield the largest possible return, yet no such schedule can be successfully maintained unless the individual rates are such as will yield some return over the cost of the service. Viewing the situation from the standpoint of the public, its only interest is to secure reasonable individual rates, and the question of the gross profits is wholly immaterial. The favoritism resulting from regulation which compels the owner to furnish certain classes of service at less than cost and to charge the loss against the balance of the service, is wholly repugnant to the duty of public service. Although there may be some question about the rule at common law, yet statutory law in the United States and in most of the states compels such public service corporations as railroads to render service to all at reasonable rates and without unjust discrimination.[2] Any discrimination by a public service company which consists in rendering a service below its cost is unjust discrimination and unlawful. It is inconceivable that a method or test would be adopted which would compel the company to do the very thing which the statutes forbid. *Any fundamental rule, therefore, of rate regulation must preserve to the company both the right and the ability to render particular services at remunerative rates.*

An action was brought to enforce an order of the Interstate Commerce Commission directing certain railroads to cease charging a greater rate from the seaboard to Chattanooga than was charged to Nashville.[3] The complaint was made under the fourth section of the Interstate Commerce Act, forbidding a greater aggregate charge for the shorter than for the longer haul on the same line. The court, however, held that the competitive condi-

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[1] Covington, etc., Co. *v.* Sandford, *supra*, 596, 597; Smyth *v.* Ames, *supra*, 544.

[2] Interstate Commerce Act of 1887. Interstate Com. Com. *v.* B. & O. R. R., 145 U. S. 263; Western Union Tel. Co. *v.* Call Pub. Co., 181 U. S. 92, 100. Mr. Justice Brewer said: "As a consequence of this, all individuals have equal rights, both in respect to service and charges. Of course such equality of right does not prevent differences in the modes and kinds of service and different charges based thereon. There is no cast-iron line of uniformity which prevents a charge from being above or below a particular sum, or requires that the service shall be exactly along the same lines; but that principle of equality does forbid any difference in charge which is not based upon difference in service, and even when based upon difference in service it must have some reasonable relation to the amount of difference and cannot be so great as to produce unjust discrimination."

[3] East Tennessee, etc., Ry. Co. *v.* Interstate Com. Com, 181 U. S. 1 (April 8, 1901).

tions at Nashville created the dissimilarity contemplated by the statute, and that the railroad companies were justified in making a lower rate to Nashville, provided such rate to Nashville was not less than the cost of service. Mr. Justice White said [1] that "if rates charged to the shorter distance point are just and reasonable in and of themselves, and if it is also shown that the lesser rate charged for the longer haul is not wholly unremunerative and has been forced upon the carriers by competition at the longer distance point" a discrimination in favor of the more distant point is not forbidden by the Interstate Commerce Act. Continuing, he said: [2]

"Take a case where the carrier cannot meet the competitive rate to a given point without transporting the merchandise at less than the cost of transportation, and therefore without bringing about a deficiency which would have to be met by increased charges upon other business. Clearly, *in such a case, the engaging in such competitive traffic would both bring about an unjust discrimination and a disregard of the public interest, since a tendency toward unreasonable rates on other business would arise from the carriage of traffic at less than the cost of transportation to particular places. . . .*[3] Applying the principle to which we have adverted to the condition as above stated, it is apparent that if the carrier was prevented under the circumstances from meeting the competitive rate at Nashville when it could be done at a margin of profit over the cost of transportation, it would produce the very discrimination which would spring from allowing the carrier to meet a competitive rate where the traffic must be carried at an actual loss. To compel the carriers to desist from all Nashville traffic under the circumstances stated would simply result in deflecting the traffic to Nashville to other routes, and thus entail upon the carriers who were inhibited from meeting the competition, although they could do so at a margin of profit, the loss which would arise from the disappearance of such business, without anywise benefiting the public."

The objection is urged that the public alone has the right to complain of discrimination which results in transferring the cost of rendering a certain class of service and placing the burden upon another class of service, and that the owner of the property affected has no constitutional rights which the courts will consider.[4] This

[1] P. 18. [2] P. 20. [3] The italics are the writer's.

[4] In respect to the test laid down in Smyth *v.* Ames, Mr. Freund, in his work on Police Power, says, § 551: "It is true that under it unequal returns may be received

position fails to take into consideration the matters above considered. If the regulation compels a company to render a substantial, definitely ascertainable portion of its service at less than cost, it is inevitable that this loss must be distributed over the balance of the business, unless the owner can refuse to render the service. The latter alternative is impossible in case of public service companies. If the service carried at a loss results in burdening the balance of the service to any considerable amount, no court would sustain the reasonableness of the rates charged that portion of the business. In course of time all of the traffic carrying the unjust burden will by legal procedure or otherwise be relieved of the same. The question then arises, how can the company make good the deficit arising from the class of business which it is compelled to carry at a loss? Where the above state of facts exists the inevitable result is the impairment of the capital of the company. The judiciary should certainly not subscribe to the absurd contention that the railroad must wait until this burden has been shifted back before it can make the claim that such rates will result in impairing its property. So inevitable a result should and will be anticipated in the establishment of a proper test or rule for the determination of the constitutionality of specific rates.

A reasonable maximum rate, as used in a constitutional sense, therefore, cannot be determined without considering the rights of both the owner of the property and the public. These rights receive substantial protection by the rule laid down in Smyth *v.* Ames wherever the regulation consists of a schedule of rates based on the classification adopted by the owner. Where, however, this rule is wholly inappropriate for the determination of the reasonableness of the rate, the fundamental test must be the propriety of such maximum rate in respect to whether the rate will return to the owner the fair value, or at least the cost, of every substantial class of service demanded and rendered. This test affords ample protection to the public against unreasonable and extortionate rates of charge, and therein fulfils the only legitimate purpose of the police power in respect to purely economic interests. It encourages and permits individual effort and enterprise, and is thus in harmony

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for equal services or equal returns for unequal services; but if the return on the whole business is fair, it must be that a too small return on some part of it is offset by a more than normal return on some other part; if, then, there is ground for complaint, it is on the part of a portion of the public and not on the part of the railroad company."

with that policy of government which grants to the individual the "utmost possible liberty and the fullest possible protection to him and his property."[1] The Fourteenth Amendment not only forbids the confiscation of property by the exercise of a usurped power, but also is a constitutional restriction against the improper exercise of a conceded legislative power. The function of the "due process of law" clause is to confine legislation within its proper limits. A state enactment, therefore, although purporting to be a legitimate exercise of the police power, is in fact a usurpation of power when it imposes upon a person rendering public service the duty of furnishing, and at the same time confers upon the public the right to demand, a substantial and definitely ascertainable class of service at less than cost.

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[1] Budd *v.* New York, 143 U. S. 517, 551.